10th Anniversary

Asset growth soars in decade

10 largest private funds swelled from $25 billion to $97 billion

10 largest corporate funds: assets ($ millions)	1972	1982
AT&T	$8,885	$40,100
General Motors	3,570	13,800
General Electric	2,302	7,388
IBM	1,022	6,986
Ford	2,509	6,038
DuPont	1,816	5,253
U.S. Steel	2,239	5,566
Exxon	1,102	3,530
Westinghouse	802	2,815
Eastman Kodak	346	3,093
Mobil	360	2,200

NEW YORK — The assets of the nation's private pension funds have doubled every five years and now total more than $760 billion.

The growth of these assets is shown vividly by the growth of 10 large corporate pension funds and 10 investment management firms during the past decade.

Ten of the largest corporate pension funds had assets totaling $25 billion at the end of 1972. By Sept. 30, 1982, they had assets totaling $97.3 billion, showing a 14.5% compound annual growth rate.

However, the growth rates of the funds vary significantly, depending on the age of the plan, the nature of the company and its industry.

The American Telephone & Telegraph Co. pension plans, for example, had assets at the end of 1972 of $8.9 billion. By Sept. 30, this had grown to $40 billion, a 16% annual growth rate.

In 1972, the AT&T pension assets were in more than 20 separate pools managed independently by the regional Bell System companies. In 1980, the funds were merged into one asset pool overseen by an investment staff at AT&T headquarters in New York.

Now, under the breakup of the Bell System as part of an antitrust case settlement, the assets will be parceled out among eight operating companies.

One of the fastest growing pension funds in the past decade has been the IBM Corp. pension fund. It grew at a better than 20% annual rate from $1.022 billion in 1972 to $7 billion on Sept. 30, 1982, to $10.1 billion on Sept. 30, 1983. The IBM fund is projected to grow to $25 billion by 1990 and $65 billion by 2000.

These projections rest on critical assumptions about economic growth, company growth, salary growth, a 5% inflation rate and a capital market that provides a good equity risk premium. They also assume 60% of IBM's fund assets will be invested in U.S. and foreign equities. This last assumption might change, however.

The heavy industry pension funds have had a slower growth rate. The Ford Motor Co. and United States Steel pension funds, for example, each grew at a little more than 9% a year during the decade. The General Motors Corp. pension fund was an exception; its fund assets grew at a 14.4% rate from $3.5 billion to $13.8 billion.

As the assets of these pension funds grew, so did the number of money managers they used. The types of managers used changed also. For example, in 1972 these funds used 107 banks, five insurance companies and 29 investment counseling firms. In 1982, they used 90 banks, 18 insurance companies and 101 investment counseling firms.

Eleven banks had been counted twice within the Bell System in 1972 because each was used by more than one Bell subsidiary. This double counting was ended when the Bell System funds were merged in 1980, accounting for some of the decline in the number of bank assignments.

More significant than the decline in the number of bank appointments is the surge in the number of investment counseling company and insurance company appointments.

This clearly shows investment counseling firms were the big winners in terms of market share within the pension industry during the period. But insurance companies more than held their own, largely because of sales of guaranteed investment contracts and real estate investment funds.

Where AT&T and its subsidiaries used only 15 investment counseling firms in 1972, they used 48 in 1982. Similarly, while General Motors used 12 banks in 1972, it used 14 banks in 1982, but it also used three insurance companies and seven investment counseling firms.

In 1972, IBM used four banks and four investment counseling firms to manage $1 billion. That shifted to four banks and 15 investment counseling firms for $7 billion 10 years later.

In 1972, Eastman Kodak Co. used seven banks and one insurance company. In 1982, it used two banks, four insurance companies and nine investment counseling firms.

Mobil Oil Corp., which in 1972 used three banks, three investment counseling firms and one insurance company, used five banks, seven *counseling firms and two insurance* companies a decade later. ■

Trust banks' portion devoured by other firms

Institutions wrestle for lion's share of market

By Richard J. Gillespie

NEW YORK — Pension funds are the fastest growing sector of the U.S. financial market, and the institutions managing fund assets are growing with them, claiming effective control over vast amounts of the nation's wealth.

However, great changes are taking place within the investment management world as some types of institutions lose market share and others gain.

The growth of the nation's corporate and state and local government pension assets makes them a prize worth pursuing for the financial institutions.

According to *Pensions & Investment Age* estimates, the top 1,000 pension funds grew by about $280 million every day in the 12 months ended Sept. 30, 1982.

That year, American Telephone & Telegraph Co. alone invested $1.95 million in new contributions to its employee benefit funds each working hour.

These funds are being fought over by banks, insurance companies, investment banking firms, brokerage firms, independent investment counseling firms, mutual funds, real estate developers, oil and gas drillers, venture capital partnerships and even foreign merchant banks and brokerage concerns.

At least 50 new investment management organizations have been formed so far this year to seek to manage pension assets, at least 50 were formed in 1981, and a slightly smaller number in 1982. Some of those formed in 1981 are managing almost $500 million each.

The regular formation of new investment organizations by investment professionals departing banks, insurance companies or other investment counseling firms is just one of a number of trends within the institutional investment world.

Another trend on which a number of investment management consultants agree is that in the past decade, billions of dollars in pension assets have slipped out of the clutches of the trust banks.

Instead, an increasingly high portion of new pension fund cash is falling into the hands of insurance companies and the entrepreneurial investment counseling firms.

A third trend is also clear: a broad-based movement to diversify pension funds across asset classes, which has driven pension managers into new areas such as real estate, international investments, oil or gas deals and venture capital.

A fourth was spotted by two consultants: some money managers have discovered the small and medium-sized pension fund market, which formerly was ignored by almost everyone except bank trust departments.

Of all these trends, by far the strongest is the failure of bank trust departments to maintain their market share.

"(Figures show that) the bank trust departments have taken a beating since 1975," according to Allan Grody, a partner with Coopers & Lybrand who carried out a major survey on trends in the banking industry.

The banks' lapsing market share has been partially concealed because of the phenomenal growth in the total amount of pension fund dollars available for investment. But while the total amount managed by banks might have grown, their relative share has shrunk, figures show.

However well the banks did in the past decade, the investment management boutiques and the insurance companies did better. Where investment boutiques offered specialized management, insurance companies plowed into the market with some popular investment alternatives, among them guaranteed investment contracts and real estate commingled funds, as well as some new specialized fixed-income management techniques evolved through the management of their own assets.

At the same time, mutual funds were nibbling away at the low end of the pension fund market. More recently, brokerage firms, long considered the pariahs of the investment management community, have been attracting an increasing share of the bank trust department's bread and butter.

Most theorists consider the banks have lost market share because they are unable to hold onto investment talent. The most successful investment management strategists seem to find it hard to live within the rigid corporate and salary structures of a bank.

At the bottom line, bank board chairmen and presidents seem to find it hard to pay the kind of salaries investment managers can demand. Where 10 years ago a bank chairman would choke on the prospect of paying managers their market worth, recently an easier way around the problem has been found.

Banks increasingly are splitting trust divisions off into seemingly independent subsidiaries, thereby removing investment managers from the jealousies and rivalries that pervade large organizations.

"Ever since the late 1970s, you have seen banks spinning off their trust departments into stand-alone investment management companies, giving them a new name and a new president, and for all intents and purposes, trying to meet the competition by being like them," said Mr. Grody of Coopers & Lybrand.

The list of banks that have adopted this strategy to stem the erosion in relative market share reads like a "Who's Who" of American trust banks. That list includes such names as Bank of America, which set up BA Invest-

Continued on page 48

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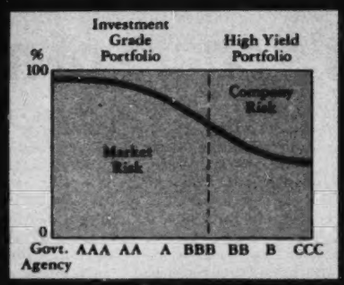

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Institutions wrestle for share . . .

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ment Management Corp.; Chase Manhattan Bank, Chase Investors Management Corp.; and Crocker National Bank, Crocker Investment Management Corp.

Most recently, Chemical Bank set up Favia, Hill & Associates in New York, and Mellon Bank hired the chief investment officer and several other key bank personnel from Wells Fargo Investment Advisors to set up Mellon Capital Management Corp. in San Francisco. Banks evidently are trying to give pension fund sponsors the impression their trust investment divisions are independent organizations, according to Mr. Grody. But is it just a question of disguise?

"Most of these entities are registered investment advisers under the 1940 act, which again is a small point, but technically these organizations are trying to make themselves look like investment counsel firms," said Paul Berg, president of Berg Fiduciary Consultants.

"But to date they have been reluctant to share equity with the principals running the units. They have set up incentive arrangements, but they don't compare to owning 40% of the company."

The question remains whether truly gifted bank investment managers will remain with the newly "independent" investment counseling firm when they could be getting a six-figure share of equity instead of a five-figure salary.

It is an overriding problem faced by not just the banks.

Even the new investment counseling firms face this dilemma, where the second-tier principals who believe they are not getting their fair share go off on their own, often taking with them a couple of their former accounts.

In this way, Montag & Caldwell of Atlanta grew out of Wall, Patterson, McGrew & Hamilton; Pacific Financial Research of Beverly Hills was started by James Gipson, formerly with Batterymarch Financial Management of Boston; and McCowan Associates of New York originated out of Goldman, Sachs & Co., to name a few.

The trend toward setting up independent investment subsidiaries is, in Mr. Berg's view, simply part of a deeper-rooted movement toward specialization and independence in the money management industry. The bottom line, he said, was that banks, investment counseling firms and insurance companies are converging on the pension fund market in the same way that investment counseling firms always have approached it, with specialized products on an unbundled fee basis.

"Banks, years ago, were able to depend upon fails float and uninvested cash balances to bring the bank into the black," Mr. Berg said.

"That has gone by the wayside. As a result, the banks have moved to an unbundled fee structure where each entity must stand on its own for profitability, which caused banks to spin off investment counsel-like subs."

Where pension funds once might have received investment management, custodial and trust services in a single package, unbundling costs to make each bank department stand on its own feet will have one inevitable consequence, Mr. Berg said: higher fees.

He said the trend to higher fees probably would continue because "plan sponsors do not seem reluctant to pay them."

Beyond increasing specialization is the growing interest in small and medium-sized pension funds.

The low-end market is one in which mutual funds and brokerage firms are expected to excel, but it is also one in which bank trust departments are well-placed, according to Edmund Mennis, former chairman of the $2.5 billion trust investment subsidiary of Security Pacific Bank, Security Pacific Investment Managers.

Today, Mr. Mennis acts as a consultant to investment managers, advising them on where to target and how to market their services. The small and medium-sized funds are the high growth area of the business, he suggested.

"The mutual funds have not made much of a dent in the corporate pension fund market," said Mr. Mennis, who now is assisting two mutual funds in attracting smaller pension funds.

"There is an effort to get into that smaller market. I think the banks can do it with the commingled funds, the insurance companies because of guaranteed investment contracts, and the mutual funds because of their wide selection," he said. ■

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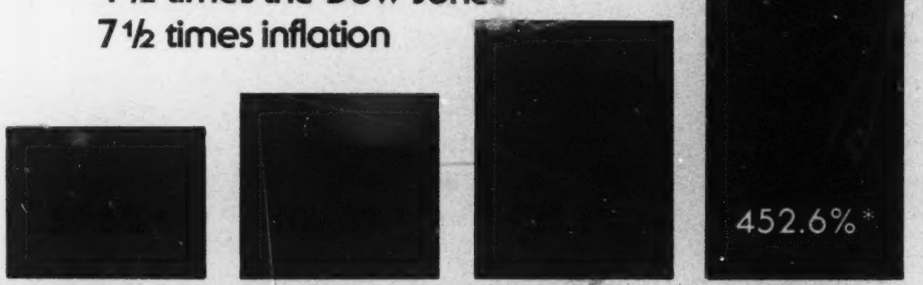

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Who owns corporate America . . .

10 largest block transaction in the first nine months of 1983

date	stock	size of transaction
5/25	Ramada Inn	7,000,000
6/14	General Tire & Rubber	6,020,600
3/30	RCA	5,368,900
4/27	J.P. Stevens	3,967,000
2/1	Alcan Aluminum	3,200,000
6/23	Gulf & Western	3,088,700
9/28	Continental Corp.	2,579,700
1/6	Aluminum Co. of America	2,500,000
8/12	Brunswick Corp.	2,490,000
9/1	Bethlehem Steel	2,321,300

10 largest block transactions of all time

date	stock	size of transaction
5/25/83	Ramada Inn	7,000,000
9/10/82	Federal Natl. Mortgage Assoc.	6,290,700
6/14/83	General Tire & Rubber	6,020,600
3/30/83	RCA	5,368,900
6/16/82	United States Steel Corp.	5,250,000
3/14/72	American Motors Corp.	5,245,000
4/8/82	Houston Industries Inc.	4,500,000
2/18/82	Dow Chemical Co.	4,000,000
4/27/83	J.P. Stevens	3,967,000
12/30/81	Duke Power Co.	3,335,800

Source: New York Stock Exchange

Continued from page 26

but we all know that the pension fund assets have been growing tremendously," observed Richard B. Lohrer, treasurer of the Northrop Corp. in Los Angeles. "I have never heard of a company that contributed less this year than it did last year to its pension fund."

Catering to small companies

The thirst for new equity in the '80s might lead to an increase in investment banking boutiques catering to small and medium-sized companies, according to some observers.

From the investors' point of view, such firms could help identify new ventures and provide an opportunity to realize higher returns.

"I worked very hard to get the "prudent man" rule expanded, and finally got it to where you had to look at the entire portfolio just to make that judgment, rather than just looking at that company," said Sen. Lloyd Bentsen, D-Texas, a member of the Senate Finance Committee, the Joint Economic Committee and the Joint Committee on Taxation.

"I think (the rule) ought to be expanded some more in order to do all we can to encourage portfolios to look not just at the Fortune 500 but to look at some of the smaller companies and to provide venture capital and to try to provide capital to small business.

"There can be some enormous rewards when they find a real winner. It has to be done legislatively. What you normally see is that pension managers have been quite conservative in their investment strategy.

"I don't think you can get a position where you coerce the management of pension funds into venture capital. But I do think that you ought to do those things that you can . . . to give the pension fund manager more freedom to do so."

From the viewpoint of the portfolio manager, however, it takes a disproportionate amount of time to keep up with smaller companies than it does to follow the moves of the mature firms.

Some critics charge that portfolio managers have developed a herd instinct, to the extent that they "study each other's portfolios" rather than study the management, the experience and the markets of the companies themselves.

"I would think that the funds that invest in the S&P 500 may not do as well as those that invested in the Wilshire 5,000," said William L. White, Sylvan C. Coleman professor of financial management at the Harvard Business School. "I would bet that you ought to do that. The state pension funds that don't invest in the littler companies may do less well."

The Wilshire 5,000 is a broad market index that includes the companies in the S&P 500 and smaller companies.

"I don't think that the problem of the '80s is going to be a lack of money for little companies," Mr. White continued.

"I think there is also going to be a big interest on the part of (small) corporations that want the money to find investment banks that will open the market to them. I think there will be a great search on the part of savers and companies for these specialty firms.

"Now, I guess I do believe that Morgan Stanley and the like will try to develop such a capability. But I think there still will be big business in financing mature companies, which I think the larger investment banks will do."

Pension funds' focus on stocks and bonds will undergo changes in

Continued on page 62

Illinois lists record return

CHICAGO — The $1.6 billion Illinois State Board of Investment had its highest return ever in fiscal 1983, according to the board's annual report.

For the year ending June 30, the fund earned 44.1%, the best return earned by the board since it was established 12 years ago.

The fund comprises the General Assembly Retirement System, the Judges' Retirement System and the State Employees' Retirement System of Illinois.

Last year proved a good one for public funds. The Los Angeles Fire and Police Pension System earned a 46.9% return in fiscal year 1983 ending June 30, the highest return in its history.

A shift in asset mix brought the Illinois fund good returns. The report states: "The Board's steadfast policy of retaining the fund's fixed-income position coupled with the increase in common stocks contributed significantly to the fund's dramatic results."

Equities made up 51% of the $1.6 billion board's investments during 1983.

In May, the Illinois fund placed $50 million in mortgage pass-through securities issued by Investors Conduit Corp.

The mortgages will be issued for newly constructed residences in Illinois.

It also hired three real estate managers in 1983, in pursuit of its goal to hold 10% of the fund in real estate.

The First National Bank of Chicago, JMB Institutional Realty and Heitman Financial Services were chosen.

The fund's management fees dropped in 1983. Fees were $451,116 in 1983, or 0.03% of pension assets, against $471,045 in 1982, 0.04%. ■

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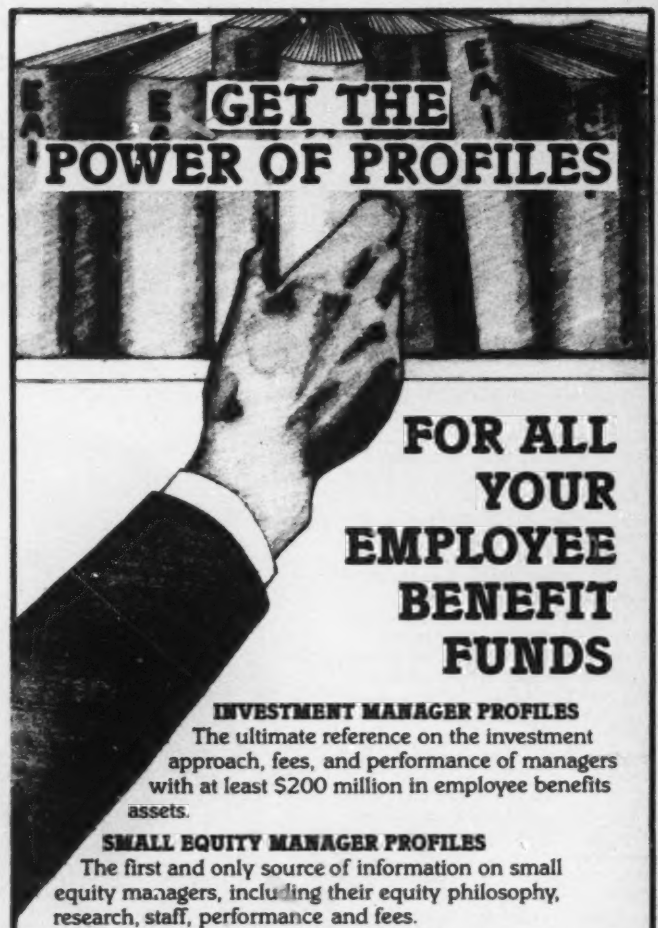

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Who owns corporate . . . .

Continued from page 61

the next two decades, said Charles Miller, president of Criterion Investment Management Co. in Houston, which manages more than $5 billion.

Mr. Miller does not share the premise that industry ownership is increasing as steadily as the consensus says it is. In his opinion, institutions came to hold a large share of the equities market because negative tax laws — such as higher capital gains taxes — made stock investments a poor choice for individual investors in the 1970s.

"Stocks aren't and didn't turn out to be an inflation hedge during the most sustained and rapid inflationary period in history," he said.

The system encouraged individuals to own real estate and other tangible assets. "Institutions became big owners of equities, and it was a mistake," he said.

Recent tax law changes have made stock investments again favorable for individual investors. But individual participation in the equity markets is likely to be channeled through institutional vehicles.

"(The 1980s) will be an environment where a number can prosper, not one against the other," he said.

Pension funds — the least regulated of any major pool of money — might be more and more pressured to diversify in the evolving financial environment.

"There's no financing function the pension fund shouldn't be doing, probably," Mr. Miller reflected.

That realization already is crystalizing in the financial industry. For instance, the mortgage industry — a major user of credit — is repackaging its products in forms pension funds can use.

The other institutions also are evolving. The mutual fund industry, for example, continues to offer an ever wider range of investment vehicles, including a number of very specialized equity funds that invest in specific market segments.

Banks, insurance companies and even brokerage houses are evolving into full-service financial institutions. Their competition for the investor's dollar will accelerate the institutionalization of personal investing.

"Give me too"

As more and more eyes watch the growing institutionalization of the markets, and the growth in pension assets that is propelling it, a "give me too" mentality has been forming among eager onlookers.

Pension assets no longer are viewed, especially by politicians, merely as retirement funds for working America, but as pools of capital for national or regional development.

Such pressures also visited other financial institutions in the past. For instance, under pressure from the Johnson administration in the mid-1960s — and into the early 1970s— the life insurance industry obligated itself to support the national housing program and tried to reach agreed-upon targets to make job-creating investments.

As a result, to this day, the insurance industry has a corporate social responsibility clearinghouse, the American Council of Life Insurance, in Washington D.C., through which companies exchange information on their investment plans. Such investments, a fraction of total insurance investments, are a specialty function.

"Pension funds are a unique national resource," said Lawrence Litvak, author of "Pension Funds and Economic Renewal" and an investment officer with the asset management division of U.S. Trust Co., Boston.

"They are a type of financial intermediary that doesn't exist in Japan or Western Europe (with the exception of the United Kingdom), our competitor countries.

"Secondly, they have very long time horizons and financial characteristics that make them more suited to investing in equities, and generally in more aggressive investments than other financial institutions or individuals.

"They have large portfolios, which make them very efficient poolers of risk, and they are sizable enough that they can support sophisticated investment management services. So, vis-a-vis individual investors, they are in a better position to make equity investments and not just in publicly traded equities, but in venture capital and in other areas as well."

Some argue, therefore, that pension assets have certain positive characteristics for an economy that needs a maximum amount of growth-oriented, "patient" capital.

Pension funds have the ability to bear risk and illiquidity in Mr. Litvak's view.

"How productively those funds are invested will determine in aggregate how well the economy does, and in turn the real levels of consumption for both retirees and workers for decades in the future," he said.

Constraints

Certain instititutional and legal constraints exist that tend to limit productive investments, in Mr. Litvak's view.

"With the public pension funds, it is most obvious on the legal side in the way that they are regulated," he said. "Generally, (they have) legal list kinds of regulations that are often quite archaic and don't allow efficient investment, and really restrict capital much too heavily to mature larger corporations.

"On the private side with ERISA, that has in large part been remedied, at least since the summer of 1979 when ERISA started being interpreted in a more liberal fashion.

"But there are still things that come up with private pension regulation, such as the interpretation of what a plan asset is, and how that will affect the ability of pension funds to invest in venture capital.

"Most of the policy-making for these large pools of capital is done by part-time, relatively unsophisticated trustees.

"Even the more conservative elements of this industry ought to be concerned with the pattern of investments by pension funds, and obviously they can dismiss the question by saying: 'If they are unfettered, and they are, then they will do what's best to pursue the highest risk-adjusted returns and we don't have to worry about it.' But there are clearly factors at play that make it more complicated.

"Economywide, there need to be changes that facilitate good productive investments on the part of pension funds. I think part of that needs to be done at a regulatory level, through creative deregulation. There ought to be a federal pre-emption of state legal lists to substitute an ERISA-type regulation for public pension funds — at least one-third of all pension capital is public.

"The federal government and state governments, as some have already, need to become more active in promoting investment vehicles that will help bridge the institutional gap between pension funds, or large pools of institutional capital, and the very large number of medium-sized and smaller enterprises around the country.

Continued on page 63

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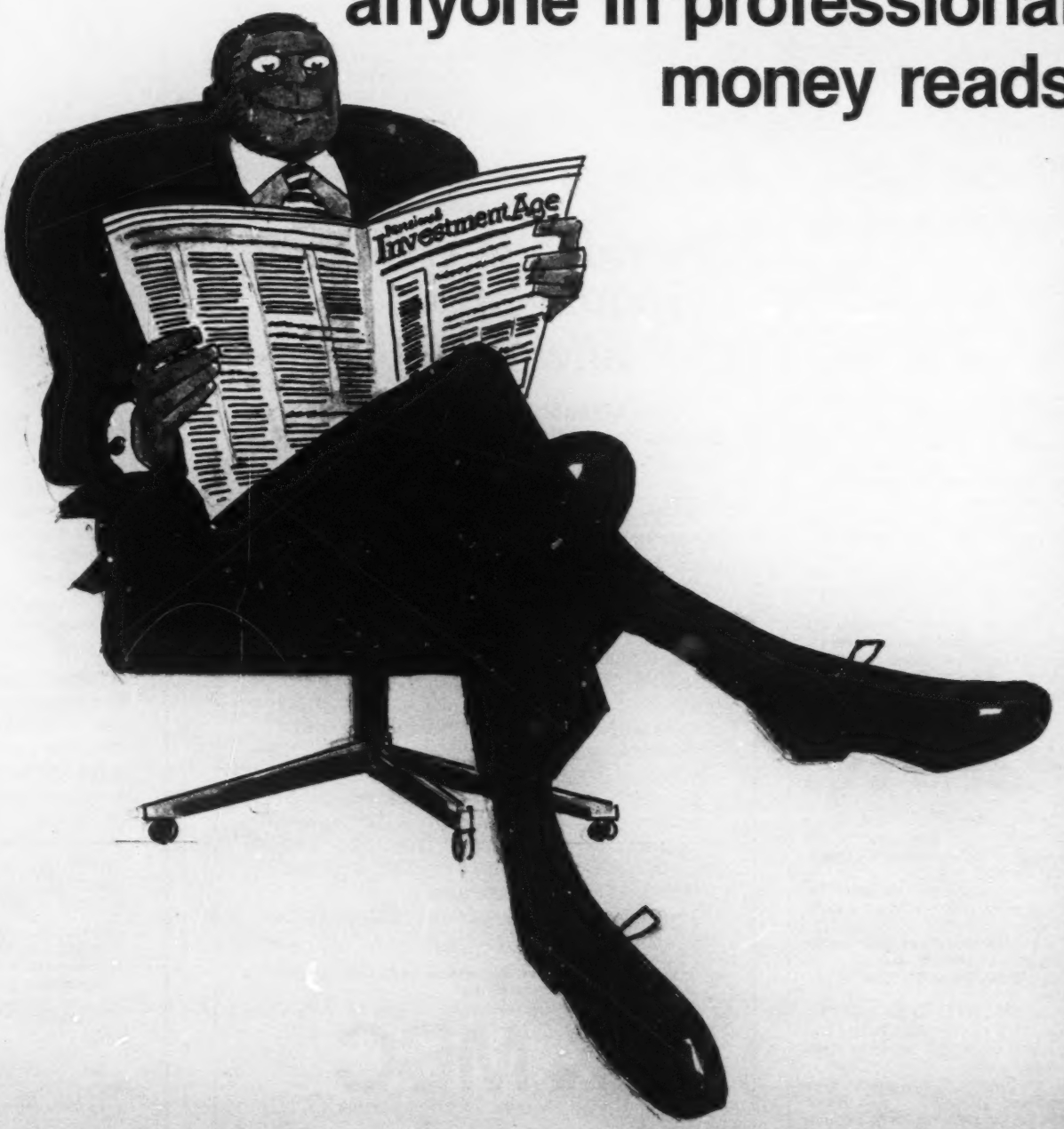

Total asset growth projections

	1960	1970	1983	1985**	1990**	1995**	2000**	Annualized rate of growth 1960-83
Households	973	1,926	5,871	6,860.6	10,127.3	14,949.3	22,067.3	8.1
Foreign	63	132	502	601.9	947.6	1,491.7	2,348.3	9.5
Mutual funds	17	47	120	142.3	218.0	333.8	511.3	8.9
Life insurance cos.	116	201	605	699.2	1,003.7	1,441.0	2,068.7	7.5
Other insurance cos.	26	50	222	267.6	427.1	681.7	1,087.9	9.8
Private pension plans	38	110	609*	763.9	1,346.3	2,372.7	4,181.4	12.0*
State & local gov't plans	20	60	303	384.2	695.4	1,258.7	2,278.2	12.6
Savings institutions•	118	270	1,042	1,258.5	2,017.7	3,234.7	5,186.0	9.9

•All savings institutions listed in sector statements, combined.
*Pensions & Investment Age estimates.
**P & I Age projections based on annualized rate of growth 1960-1983.

Source: Board of governors of the Federal Reserve System, flow of funds accounts, sector statements of financial assets and liabilities.

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"The issue of legislation that affects pension funds up until two years ago was very obscure, now it is an important middle-level issue — not like the budget deficit or what to do about Marines in the Lebanon, but no longer is it an arcane area of our policy."

In the opinion of Karen Ferguson, director of the Pension Rights Center, there might be growing demands to free pension fund money from control by corporate sponsors. The center, a non-profit organization that represents pension participants, is more heavily involved in benefit issues than in investment issues.

Political pressures

The fragmented pension industry — where each company caters to its own interests — will be confronted by increased investment pressures in the future.

"As pension funds grow, they'll certainly gain political attention in Washington," said Dan Forrestal, president of InterFirst Investment Management, Dallas.

The potential "political sensitivity" is especially increased for pension funds with the funding deficiencies of the Social Security program

"Pension funds will continue to play an important role in the institutionalization of the saving and investment function because inflation has made people realize that the Social Security system is, essentially, only a backup," said Rep. Timothy E. Wirth, D-Colo., chairman of the House Democratic Caucus' Task Force on Long-term Economic Policy and chairman of the House Energy and Commerce Committee's Subcommittee on Telecommunications, Consumer Protection and Finance.

"The more liberalized tax treatment of IRAs reflects a recognition that inflation means an additional backup system to the two we already have is needed, and the recognition of the need to increase the savings rate," he added.

Politics already has affected the direction and the rate of the institutionalization of savings and investment, and thus the ownership and control of corporate America.

The passage of ERISA in 1974 caused money to flood into pension funds as companies began to fund their plans more systematically. In addition, it heightened the awareness of employees that indeed they were covered by a pension plan and, provided they met certain conditions, they could expect to receive a pension from their employers.

However, ERISA caused a modest change in the shape of pension coverage, slowing the rate of defined benefit plan formation and accelerating the rate of defined contribution plan formation.

In a defined benefit plan, em-

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Who owns corporate America . . .

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ployees have no direct connection with the investments held to their benefit by the pension trust. They simply have the promise that the investments back the monthly pensions they have been promised, and they have the corporation and the Pension Benefit Guaranty Corp. to fall back on, should some disaster strike the investment portfolio.

In a defined contribution plan, however, the employees have individual accounts that gain or lose value as the investments in the fund increase or decrease in value. The employees' pensions are tied directly to the fortunes of the investments in the fund.

Thus, defined contribution plans encourage greater employee involvement in the investment process, if only as observers. The feeling of ownership of the assets is greater. Employees are more likely to object to particular investments.

The new shape

This impact of ERISA is being reinforced by later developments that are fostering the defined contribution and employee involvement mentality. The passage of the Tax Equity and Fiscal Responsibility Act of 1982 seems to have discouraged again the formation of defined benefit plans and to have encouraged defined contribution plans.

Before TEFRA, the passage of the Economic Recovery Tax Act of 1981 liberalized rules for individual retirement accounts and encouraged 401(k) salary reduction plans, both of which are, in effect, defined contribution plans.

Both allow individuals the opportunity to direct their own investments.

Confronted by apparent threats on several fronts and encouraged by rapid asset growth that has left their plans overfunded as regards current liabilities, many companies are terminating their defined benefit plans, recapturing the surplus assets and starting defined contribution plans in their place. Among the perceived threats are increasing pension costs, a Congress that seems hostile to defined benefit pension plans and a Financial Accounting Standards Board proposal to put pension assets and liabilities on the balance sheet.

The next generation of pension plans thus might be defined contribution plans, which place the investment and retirement burden on plan participants.

Here to stay

The institutionalization of the markets, nevertheless, is here to stay — even if there is a tremendous growth in individually directed investments.

"The retail market is tending to become institutionalized," said Thomas W. Archibald, senior vice president at the trust and investment services division at Irving Trust, New York.

"The financial industry is out with tremendous advertising campaigns, and the investment vehicles they are talking about — mutual funds and so forth — are in many cases institutional vehicles.

"You have literally millions of Americans now opening IRA accounts and getting used to investing through institutional vehicles. And the longer they have that IRA and the bigger it gets, they are going to get acclimated to using the services of an institution. That's a psychological factor there. Institutions are not going to be perceived as being dehumanized.

"The individual investor was mauled by the collapse of the stock market in 1973-'74. Even today, he has not fully recovered from that beating, consequently he stayed out of the market for a long time. Slowly, he came back. And when he came back, there was a tendency to find an institutional vehicle.

"There used to be a standard bromide on Wall Street that when your cab driver started to give you stock tips or when you heard excited conversation on the train about common stock, you were aproaching the top of a bull market. It was time to get out. I hear far fewer comments from cab drivers or people on the train this time around. I think it may mean that they are no longer investing on their own."

"The financial markets at this point in time are intimidating to many individual investors," explained Hugh A. Johnson Jr. of First Albany Corp. "This is a result of what I would call, almost, the dehumanization of the marketplace.

"First of all, the most important thing that they're intimidated by, the most obvious thing, is the extreme volatility. I think that most people that you talk to will mention that if there's anything that's different today than existed in say 1968-'70, is that the markets, particularly the bond markets, are becoming extremely volatile.

"It takes a certain disposition to approach the financial markets. Obviously, if you're going to buy a bond today and find out that it's down five points tomorrow, you tend to be somewhat intimidated by that. If you thought it might be down a quarter of a point tomorrow or half a point tomorrow, you'd be less intimidated. The volatility of the financial markets is the reason for the dehumanization or the intimidation that has occurred.

"The amount of volatility that I'm talking about exists in both the stock and the bond market."

Bewildered

Another element responsible for intimidating individual investors is the overwhelming explosion in the amount of information available on a company, its industry and almost all phases of the business process. At the same time, the social trends are pointing Americans toward enjoying their leisure time.

"Not only is the amount of information staggering, it's really left many of the individual investors somewhat bewildered and inclined to turn over the decision-making to money managers, be they mutual funds — if they're small investors — or mutual funds investment advisers, or whoever," noted Mr. Johnson.

The thesis that many individuals returning to the market, or approaching it for the first time with their IRAs, will do so through institutions seems borne out by the developments of the past year.

With the bull market in equities now more than a year old, equity mutual funds are thriving. During the 12 months ended June 30, equity mutual funds doubled in size to record total assets of $72 billion, according to the Investment Company Institute, a national association of mutual funds, in Washington D.C. During the period, 1 million new shareholder accounts were opened, bringing the total to 6.4 million.

"I think the nation's wealth is more in the hands of a great many middle-income people, and they tend to look for professional money managers rather than managing the money directly," said Mr. Hoeneymeyer of Prudential. "A large number of middle-income

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people ... are investing through mutual funds, or life insurance, or something like that."

In Mr. Hoeneymeyer's estimation, banks, insurance companies and mutual funds might win a larger share of new investment funds especially if the trend shifts toward people saving more money themselves than through pension funds.

"Maybe I reflect my biases here, but I would say that banks and insurance companies are going to grow faster than some of the other institutions," he said.

Continued growth

The consensus holds pension fund assets will continue to show considerable growth for some time yet, but there is no consensus on when the slowing will occur.

In the opinion of Lee Spencer, former Securities and Exchange Commission corporate finance division director, pension funds will continue to be the most important asset pools, surpassing even the swelling assets of mutual funds.

"First of all, the money market fund is losing ground to the banks," he said. "Equity mutual funds are just small compared with the other institutions.

"Everybody is interested in retirement, and every time you have a factor that affects every human being in the country, there are large dollar effects from that.

"At least in the private sector, most of the retirement benefit plans are paid for by the employer. That's where the money is coming from. It's not coming out of pay checks, but it's just part of the compensation employees receive. That raises a lot of profound issues.

"At the same time, people aren't relying on Social Security to be a total scheme, and are saving themselves through various plans which government policy has fostered."

"We're going to see a moderating in the growth of pension funds for several reasons," said David Williams, chairman of Alliance Capital Management Inc., which manages more than $13 billion. "We've been through the period of catch-up funding, and you could perhaps make a case that the growth of pension funds is going to slow down.

"If economic policy shifts increasingly toward tax incentives for savings, pension funds may become less attractive relative to expanded IRAs or something like that."

In Mr. Williams' view, pension growth could start tapering within 10 years.

"My own guess is that we are going to see more savings incentives, including tax breaks for individual savers," he said. "And maybe, that will just end up as being another form of institutionalized money — owned by individuals instead of corporations."

Either way, there is reason to believe the asset pool is most likely to end up being managed by institutions.

Corporate impact

Institutional ownership of corporations already has had an impact, according to many experts. It has made it easier for companies to raise capital, but it also has caused them to take a more short-term focus on profitability.

"The institutions are less demanding owners than the large shareholders," said David A. Wyss, chief financial economist at Data Resources Inc., an economic consulting firm in Boston. "In fact, I see that as a bit of a problem for corporate America, that the institutional owners aren't likely to complain about management, they're just likely to sell the stock, and I think a lot of private shareholders are more interested in what management is doing.

"The large mutual fund has no commitment to a corporation. A lot of it is quasi-captive ownership, which means — the pension plans for example — that the owners have very little say as to where the money goes."

Corporate managements, in turn, are affected by institutional perceptions. Corporations want their stock price to increase, so institutions will like their company's stock.

That puts the cart before the horse. Because, the stock market does not exist so people can make large fortunes. It exists so American industry can raise capital conveniently.

"To me, the great risk is that no one takes responsibility for making sure that the management of companies serve the owners of companies," said Mr. Kirby of Capital Guardian Trust Co. "One of the things that bothered me about this business ever since I have been in it is that the managements of very large, mature, publicly owned companies are almost like the managements of mutual insurance companies. The ownership of the company is so spread and so voiceless, that it is virtually invisible.

"Unfortunately, as institutions have gotten to own greater and greater portions of those companies, it has not only *not* helped the problem, but I think it has hurt it. Because, the professional investment management community takes a point of view that it should play a passive role.

"If you hold the stock of a company whose management starts to do things that you think are nuts, and you talk to other money managers and they agree with you ... you simply sell that stock and go buy the shares of a company which is not doing the things, or is doing things that make sense.

"In effect, you leave behind all the widows in Des Moines and retired druggists in Florida, who own the shares of the stock you just bailed out of, to suffer whatever fate may happen.

"If I had been a shareholder of Bendix, I would have said, 'What kind of flakes are running that company?'

"What you don't do as a professional money manager is call up your pals and say: 'Those guys are crazy. Let's call up and point out to them that they don't own the company — in effect, the people we represent do — and run the company for the benefit of the shareholders.' "

Even if money managers are willing to stand up and accept the responsibility of representing or protecting the owners of a company, they run into serious and complex conflicts of interest.

"I now have a growing file of irate letters I have written to companies in response to these golden parachutes kinds of things," Mr. Kirby said. "It just ticks me off so much you can't believe it. Where the thing really gets sticky, is when you take an organization like ours. We might own a couple million shares of a company which is proposing some kind of anti-takeover provision.

"We approve of those up to a point. You can't have a guy spending 20 years of his life working for a company and then get kicked out summarily without compensation or anything. But the other side, where you get the top five guys signing themselves up for $20 million cash payment in the event of an unfriendly takeover, everyone else goes down the tube, but the top guys walk out giggling all the way to the bank.

"When you get a situation where that company is a client of ours, we manage their pension fund, and other accounts that we manage own a couple million shares of their stock, and in comes the proxy and we have to call them up and say, 'I'm sorry, we are going to vote against your proposal,' they have the ability to say, 'Well, if you do, you are fired.'

"Fortunately, in a number of

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cases when we've had to say, 'I'm sorry, but in good conscience, we can only vote against your proposal,' in each case they have said, 'Okay, that is your responsibility, and we understand.'

"Oddly enough, in a few cases where the companies weren't clients, we have gotten responses such as, 'We have long memories, and if you think you are ever going to get hired to run money around here, you can forget it.'

Other conflicts include money managers' own pressure for short-term portfolio performance that moves across to pressure on management, to the detriment of the firm.

When institutional money is sensitive to neat, quarter-by-quarter performance results, there is the danger of portfolio managers trying frantically to avert a disaster and putting pressure on the management of companies to create a facade that often doesn't reflect the real circumstances of the company.

"It's kind of made business managers like congressmen," said Mr. Kirby. "They are always running for re-election, and don't want to do anything that is painful."

Such pressures can cause management to make unsound decisions vs. some other decision that would benefit the company a great deal, on a five-year time horizon.

"Basically, the institutional holder wants high profits, which is the same thing private owners want," said Mr. Wyss of Data Resources. "The only difference is probably that institutions are a little more risk averse, particularly the pension funds, than are private holders.

"I have a nasty feeling that it may be making management a little more conservative at the big companies. That's not necessarily true in smaller companies, because you have a different set of institutions."

If companies become more risk averse, it will translate into their making less new investment and, generally, not taking a chance at moving into new markets. Firms might bid to consolidate market share rather than try for big increases in profits in the longer term.

Part of the problem Mr. Kirby defines arises because, at least in pension funds, there are no clear owners of the assets. Employees are the beneficial owners, but the pension fund sponsors also have some claim to the assets. A separate entity, the pension trust, exercises some of the powers of an owner, as do the investment managers the trust hires. The ownership is diffuse, so there is no one to pressure the institutions making the investment decisions.

20 stocks most heavily owned by institutions (year-end 1981)

	% of outstanding stock
AMP	89.4
Mattel	80.1
Lockheed	79.6
SmithKline Beckman	78.8
Gannett	78.2
Motorola	77.7
Bausch & Lomb	77.2
Nalco Chemical	77.1
Kellogg	72.0
Avon Products	71.6
Merck	71.5
E-Systems	71.4
Texas Instruments	71.4
Capital Cities Communication	71.2
Anheuser-Busch	71.0
Raychem	70.5
Data General	70.3
Eli Lilly	70.0
Dieboid	67.6
National Can	67.3
Average	**74.2**

Source: *Pensions & Investment Age* compilation.

Clout

All of this might be changing, albeit slowly and reluctantly.

Institutions have both the clout and the expertise to use their voting power to affect issues in Ameri-

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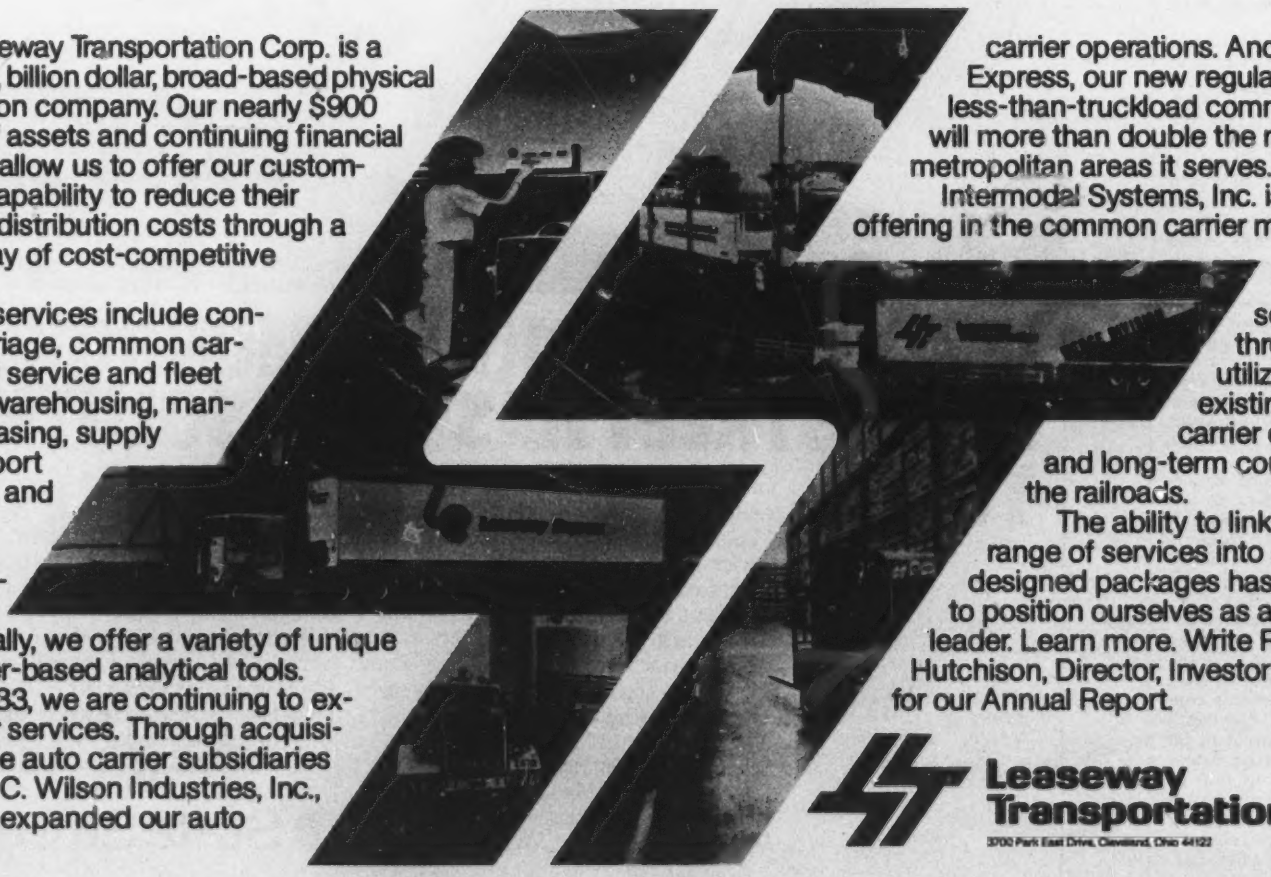
Leaseway Delivers



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can industry. As pension funds begin to exercise their voice, they might change the character of corporate America.

"The power is there, if they ever woke up to use it," said Mr. Spencer, who recently left the SEC and returned to private law practice.

"There is an increasing awareness that they have an ability to control the situation. And as that awareness builds, there will be pressures to exercise it.

"You used to have the Wall Street world, where if you didn't like it, you took a walk and didn't exercise the vote. That is not true with respect to institutions. Their votes have clout. It doesn't take too many of them to get together and have a controlling block of a company. They are beginning to pay attention to their voting power.

"But the question is, Will they use it? And how?"

"You would think that when you had a lot of corporate equities held in the hands of relatively few people, that those companies could have amazing impact on the course companies could follow," said Ms. Munnell of the Federal Reserve Bank of Boston. "I have not seen that happen.

"These people have limited resources for now, and to start adding a social dimension to their investment decisions is very difficult. If you want to do that, it will have to be done very carefully. Each investment decision is going to have to be evaluated in terms of interest and return, and compared with market instruments.

"I think that pension funds really have to be in the business of making the highest return that they can."

Labor unions, however, increasingly are showing an awareness and interest in how their pension assets are invested.

"I think the labor unions will try (to voice control), but I'm not sure how successful they will be," Ms. Munnell said. "Labor is factionalized. But there is some effort to coordinate their holdings, and their efforts."

Control

Even though in aggregate, pension funds own shares in many companies, each individual pension fund might have only a small concentration in any one stock.

There is a realization brewing, especially among union funds, that they might become much more potent by pooling their efforts.

"The clearer it becomes to union or public pension fund trustees that they can easily play a decisive role in the affairs of corporations, the much more likely they are to play that role," Mr. Litvak observed.

Pension funds and their money managers, once passive shareholders during takeovers, have begun demanding, and sometimes receiving, some consideration.

Pension fund managers such as Morgan Guaranty Trust Co. and Forstmann-Leff Associates were pursued by both sides in the battle for control of Trans World Corp. that resulted in a victory for the current management. Morgan and Forstmann each controlled about 9% of TWC stock.

Similarly, pension funds and their managers were in the thick of the successful United States Steel Corp. battle to take over Marathon Oil Co. Several funds, including the California Public Employees Retirement System and the California Teachers Retirement System, declared they would vote their proxies against U.S. Steel, as did investment management firms such as David L. Babson & Co. and Fayez Sarofim & Co., each of which manages billions of dollars.

Two union pension funds, the International Molders and Allied Workers Union and the International Association of Machinists and Aerospace Workers, have been involved in helping Tactron Inc. take over KDI Corp.

In a different way, Citibank found itself involved in the Bendix Corp.-Martin Marietta Corp.-Allied Corp. dogfight last year. As trustee of the Bendix savings and employee stock ownership plan, it had to decide whether or not it was most in the employees' interests to tender the Bendix shares to Martin Marietta.

Its discomfort was intensified by the knowledge that trustees for the Grumman Corp. pension plan had been found in violation of ERISA for not tendering that plan's Grumman stock holdings to LTV during LTV's takeover bid for Grumman.

Citibank eventually tendered the Bendix stock to Martin Marietta.

Active ownership

Pressure for investment gains might act as a catalyst and ignite interest in active ownership of stocks, some experts assert. That already has happened in Britain, where pension funds were among five large institutional investors that purchased the U.K. branch of the F.W. Woolworth Co. for $500 million in November 1982.

The funds realized an immediate profit by selling chunks of "Woolies" real estate, and planned to give new management direction to the store chain.

American pension funds might take the cue as Congress, the investing public and money managers become more educated on the implications of active ownership of equity.

"There is a growing recognition that you can't make money just trading stocks, or at least it is very difficult," said Professor Black of MIT. "The other alternative is to take a more active part in the management of the firm whose shares you own."

Professor Black hypothesized that as institutions become more aware of what their ownership of stock means, they might start taking a more active interest in corporations.

"It's one of the principle ways they can make money for their beneficiaries," he said.

"They get control — alone or with other institutions — of a firm, change the way it is managed, and increase the value of it.

"In the past, they concentrated on making money by selecting new stocks, but that turned out to be extremely difficult to do.

"They may concentrate on doing things like buying up a company and spinning off the pieces, or just simply paying attention to the management of the companies whose stock they own, and trying to encourage simple actions that increase the value of the firm."

Investment banking professionals might be potential candidates as advisers, or even in the

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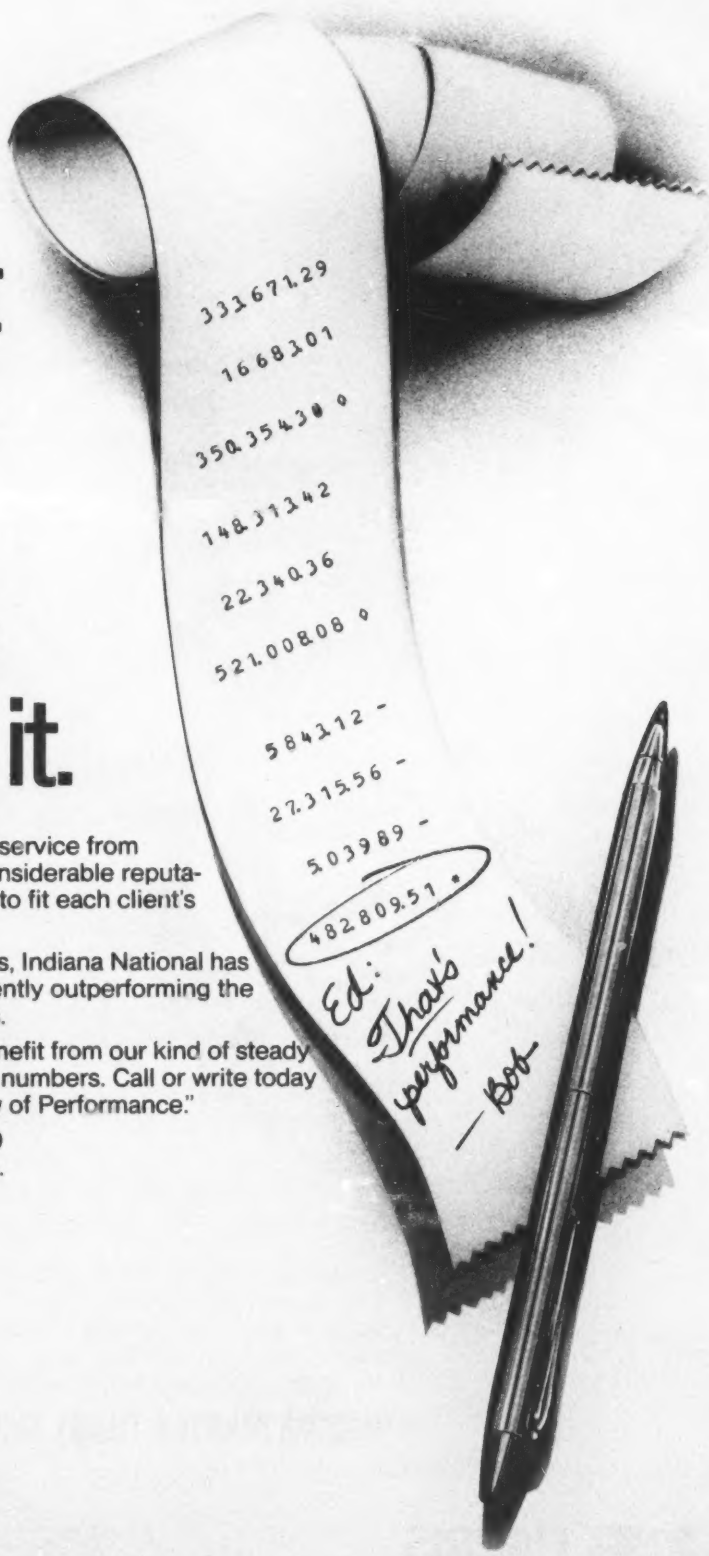

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setting up of a control mechanism.

Nonetheless, some institutional investors agree many large corporations have suffered from an absence of effective ownership rights being exercised; that management has been too dominant — especially in the takeovers, mergers and acquisitions — and institutional shareholders have not been adequately represented; and that the investment decisions being made do not have the most productive result, although they are in the interests of the management.

"I think it could be argued that if you are going to have a capitalist system that works like a capitalist system, you have to have some sort of effective representation of some interests beyond management," said Mr. Litvak of Boston's U.S. Trust Co. "I think in the future we will see a combination of management, government and large institutional shareholders, not acting exactly as traditional private owners have acted, but acting out of a combination of fundamental financial concerns and a certain social sensitivity."

Proxy voting

Major investment management organizations have begun voting some of their proxies against management — an unthinkable development only 10 years ago. The institutions have realized corporate management is not infallible, and that sometimes it has to be shaken out of complacency. Morgan Guaranty and Citibank both acknowledge voting against management positions about 50 times last year.

Public and union pension funds also are pressing corporate managements on social issues, ranging from activities in South Africa to investing in low-income housing. Their proxy votes now are merely a pinprick to management, but the impact could grow.

As pension funds become more demanding, the other institutions will find themselves following the funds, Mr. Litvak suggested.

There are dangers to pension funds if they attempt to exercise more influence over corporate management or behavior. First, they might become more visible. Second, there might be dissent within them.

"Two sets of pressure are going to be brought to bear on them as they become more noticeable," said Sylvester Schieber, director of the research and information center at the Wyatt Co., an actuarial and employee benefits consulting firm in Washington, D.C. "One is 'alternative' stockholders. If large institutional investors come in and start to somehow steer the corporate policy in a direction that's not desirable, you're going to see hostility develop toward them and you will begin to see restrictions develop to limit their investments, or ability to be active in the whole process,".

"The other side of that, which is probably more important, is to the extent they become active, the participants in the pension plans are going to look at what it is they are seeking to accomplish in their activities. If you have 100 participants in one of these plans, you've got 100 different opinions as to what should be accomplished in the investment of your assets."

To the extent that pension funds become more active, and more targeted, public opinion among pension plan beneficiaries might also become more heated.

"If you start to see internal rebellions, you will see investment managers back off from taking active roles," Mr. Schieber said.

No matter how the money is accumulated, through pension funds or through IRAs, the exercise of the voting power adds a social dimension to institutional assets with which pension funds and their managers are uncomfortable.

"My impressions are that it's a power that most money managers wish they didn't have," said Alliance Capital's Mr. Williams.

"I think most investment managers are comfortable if the only decision they have to deal with is to buy or sell stock. Those of us in the business were drawn to it because we preferred a more distant, perhaps less activist role in corporate affairs. We wanted to be spectators.

"We're mainly information seekers as opposed to telling or advising corporations on how to run their businesses. Even so, by the nature of the information we seek, there's a message on how we think the business should be run. We advise by the questions we ask."

Conclusions

The tide of the institutional revolution is flooding. American corporations increasingly are owned by faceless funds.

Pension funds, which have a vague responsibility to pensioners; mutual funds, which are jointly owned by a huge mass of the population; and insurance companies on behalf of their policy holders, now hold vast amounts of corporate shares — ownership claims against corporate assets.

So far, the revolution has been benign. Its positive aspects have far outweighed the negatives. More Americans than ever before own shares in the nation's productive wealth and their long-term economic well-being is more than ever before intertwined with that of corporate America.

If the economy slumps, not only are jobs lost, but savings through mutual funds and the safety of retirement benefits are threatened. Labor eventually should become aware of its common interest with capital for more and more it is the ultimate owner, or at least beneficial owner, of that capital.

The institutional revolution has made capital raising by corporations easier, and thus more efficient. It has made the stock market more efficient, meaning corporate enterprises are being issued more correctly by the capital markets, again improving efficiency.

Ironically, while the percentage ownership of corporate wealth by the ultrarich individuals might be declining, their influence might, for a time, increase — at least until institutions come to grips with the issue of more active ownership. Wealthy individuals pay attention to corporate management, and instead of immediately selling their holdings, attempt to influence management to better behavior.

If there is a negative to institutionalization, it is that "absentee" ownership by institutions might have made corporate management too concerned with short-term profitability. This might change as corporations and institutions adapt to the new environment.

Who owns corporate America? More individuals than ever before. Through pension funds, mutual funds and other institutions, more than half of the U.S. population has some ownership interest.

There is a threat to this ownership, however, in the huge and rapidly growing federal debt. The government has the power to tax and thus the power to destroy.

So who really owns America?

The answer, it would seem, is everyone who holds federal government debt, and has a lien on the United States. ■

Kimberly Blanton, Joel Chernoff, Richard Gillespie, Steve Hemmerick, Ivy Schmerken, Nancy Webman and Mark Westerback assisted with this article.

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